

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

WISCONSIN ENERGY CORPORATION,)	
INTEGRYS ENERGY GROUP, INC.,)	
PEOPLES ENERGY, LLC, THE PEOPLES)	
GAS LIGHT AND COKE COMPANY,)	
NORTH SHORE GAS COMPANY, ATC)	
MANAGEMENT INC., and AMERICAN)	
TRANSMISSION COMPANY LLC)	
)	
Application pursuant to Section 7-204 of the)	Docket No. 14-0496
Public Utilities Act for authority to engage in a)	
Reorganization, to enter into agreements with)	
affiliated interests pursuant to Section 7-101, and)	
for such other approvals as may be required under)	
the Public Utilities Act to effectuate the)	
Reorganization.)	

Supplemental Direct Testimony of

SCOTT J. LAUBER

Vice President and Treasurer –
Wisconsin Energy Corporation

On Behalf of
Wisconsin Energy Corporation

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 **Q. Please state your name and business address.**

4 A. My name is Scott J. Lauber. My business address is Wisconsin Energy Corporation, 231
5 West Michigan Street, Milwaukee, Wisconsin 53203.

6 **Q. Are you the same Scott J. Lauber who submitted direct testimony on behalf of**
7 **Wisconsin Energy Corporation (“Wisconsin Energy” or “WEC”) in this**
8 **proceeding?**

9 A. Yes.

10 **B. Purpose of Supplemental Direct Testimony**

11 **Q. What is the purpose of your supplemental direct testimony in this proceeding?**

12 A. The purpose of my supplemental direct testimony is to provide additional information on
13 topics identified by the Illinois Commerce Commission (“ICC” or the “Commission”)
14 Staff (“Staff”). These topics were raised in response to comments made by
15 Commissioners during the Commission’s September 3, 2014 Special Open Meeting.
16 Specifically, the Commissioners sought additional information in this proceeding
17 concerning the impacts of the financial strength and capital structure of Wisconsin
18 Energy on The Peoples Gas Light and Coke Company (“Peoples Gas” or “PGL”) and
19 North Shore Gas Company (“North Shore” or “NSG”) (collectively, the “Gas
20 Companies”). The topics Staff identified are:

- 21 1. What capital structure and credit ratings will WEC target for WEC, PGL,
22 and NSG post-merger?
- 23 2. Does WEC intend to register PGL and NSG with the Securities and
24 Exchange Commission (“SEC”)? If not, why not?

- 25 3. What proportions of WEC's revenue, EBIT¹, assets, and operating cash
26 flow do/will non-utility operations represent pre- and post-merger?
- 27 4. What is/will be the amount of debt at the WEC level before and after
28 merger?
- 29 5. What is/will be the proportion of debt at the WEC level before and after
30 merger?
- 31 6. What ring fencing provisions do the Applicants propose in order to
32 insulate PGL and NSG from WEC corporate debt and non-utility
33 operations?
- 34 7. Will PGL and NSG maintain their own credit facilities post-merger?
- 35 8. Will PGL and NSG propose to join a WEC money pool? If so, on what
36 terms?
- 37 9. How will the greater size and access to capital markets for the combined
38 company be reflected in NS/PGL's requested rates of return?
- 39 10. Address the requirements of 7-204A(a)(7) (i.e., provide a version of Joint
40 Applicants Ex. 4.1) assuming the transaction is executed.
- 41 11. Provide 5-year forecasts of the Moody's and S&P financial benchmark
42 ratios for NS/PGL with and without the merger.
43

44 **C. Summary of Conclusions**

45 **Q. Please summarize the conclusions of your supplemental direct testimony.**

46 A. As discussed in more detail later in my supplemental direct testimony, I conclude the
47 following with respect to the topics identified by Staff.

- 48 • The Joint Applicants do not expect any change to the Gas Companies' capital
49 structure, credit ratings or cost of capital immediately or shortly after the
50 Reorganization closes. Additionally, the Joint Applicants do not anticipate
51 any changes to the current forecasts of capital requirements and financial

¹ Earnings before income and taxes.

benchmark ratios for Peoples Gas and North Shore.

- No changes will be made to the Gas Companies' existing credit facilities after the merger closes, and they will remain unregistered with the SEC.
- Non-utility operations will represent a very low percentage of WEC Energy Group's revenue (1.46%), EBIT (0.09%), assets (1.21%) and operating cash flow (0.47%), proportionally less than currently exists within the Integrys Energy Group, Inc. ("Integrys") holding company system.
- No new "ring fencing" provisions are needed or proposed by the Joint Applicants.
- There is no intention for the Gas Companies or any other company to enter into a WEC Energy Group "money pool agreement".²
- Any future reductions in the Gas Companies' cost of capital as a result of the greater size and access to capital markets of WEC Energy Group, will be recognized and flowed through to customers in the rates set for the Gas Companies when they file rate cases.

D. Itemized Attachments to Direct Testimony

Q. Are you sponsoring any exhibits with your supplemental direct testimony?

A. Yes. I have attached the following exhibits to my testimony:

- Standard & Poor's Ratings Services June 23, 2014 Research Update, attached as Joint Applicants Exhibit ("Ex.") 5.1;

² As that term is defined in 83 Ill. Admin. Code § 340.20.

- Moody's Investors Service June 23, 2014 Rating Action, attached as Joint Applicants Ex. 5.2;
- Fitch Ratings June 24, 2014 Report, attached as Joint Applicants Ex. 5.3; and
- Five-year forecasts of financial benchmark ratios for Peoples Gas and North Shore, attached as Joint Applicants Ex. 5.4.

II. FINANCIAL OPERATIONS

Q. Does Wisconsin Energy intend to register Peoples Gas and/or North Shore with the SEC?

A. At the present time, Wisconsin Energy does not intend to register Peoples Gas or North Shore with the SEC.

Q. Why does Wisconsin Energy not intend to register Peoples Gas and/or North Shore with the SEC?

A. Wisconsin Energy believes that maintaining the Gas Companies' current unregistered status is the most cost efficient manner for the Gas Companies to raise capital. Wisconsin Energy would consider registering Peoples Gas and/or North Shore with the SEC if, by doing so, it believed the Gas Companies could achieve net savings in their financing and capital costs. Currently, however, any reduction in the Gas Companies' capital costs would, at best, be *de minimis*, while the costs of registering with the SEC and complying with the reporting requirements would be significant.

Q. What proportions of Wisconsin Energy's revenue, earnings before interest and taxes ("EBIT"), assets and operating cash flow do non-utility operations represent at the present time, pre-merger?

94 A. The following table provides the proportion of Wisconsin Energy's non-utility operations
95 to total operations.

<u>Non-Utility % of Total</u>	WEC Pre-Merger % <u>2013</u>
Total Operating Revenues	0.03%
EBIT	-0.23%
Total Assets	1.32%
Operating Cash Flow	0.08%

96 **Q. After the merger, what proportions of WEC Energy Group's revenue, EBIT, assets**
97 **and operating cash flow will non-utility operations represent?**

98 A. The following table provides the expected proportion of WEC Energy Group's non-
99 utility operations to total operations.

<u>Non-Utility % of Total</u>	WEC Energy Group Post-Merger % <u>2016*</u>
Total Operating Revenues	1.46%
EBIT	0.09%
Total Assets	1.21%
Operating Cash Flow	0.47%

*Assumes Integrys Energy Services, Inc.'s retail business is sold

100

101 **Q. What is your conclusion regarding the impact of non-utility operations on WEC**
102 **Energy Group?**

A. Non-utility operations will represent a very low percentage of WEC Energy Group's revenue (1.46%), EBIT (0.09%), assets (1.21%) and operating cash flow (0.47%), and proportionally less than currently exists within the Integrys holding company system.

III. HOLDING COMPANY DEBT

Q. Please provide the current, pre-merger amount of debt at the Wisconsin Energy level.

A. As of December 31, 2013, the Wisconsin Energy holding company had \$817 million of debt outstanding.

Q. What will be the amount of debt at the WEC Energy Group holding company level after the merger?

A. As of December 31, 2015, the WEC Energy Group holding company is projected to have \$2,314 million of debt outstanding.

Q. What is the current, pre-merger proportion of consolidated debt at the Wisconsin Energy holding company level?

A. Wisconsin Energy Corporation's holding company debt outstanding as of December 31, 2013 is approximately 15.6% of the consolidated debt outstanding within the Wisconsin Energy holding company system.

Q. What will be the proportion of debt at the WEC Energy Group holding company level after the merger?

A. WEC Energy Group, Inc.'s holding company debt outstanding as of December 31, 2015 is projected to be 20.8% of the consolidated debt outstanding within the WEC Energy Group holding company system.

125 **Q. What will be the combined amount of debt at the holding company level for both**
126 **holding companies – i.e., at the WEC Energy Group holding company level and the**
127 **Integrys holding company level combined – after the merger?**

128 A. As of December 31, 2015, the combination of debt outstanding at the holding company
129 level for both holding companies is projected to be \$3,485 million.

130 **Q. What will be the proportion of debt at the holding company level for both holding**
131 **companies – the WEC Energy Group holding company level and the Integrys**
132 **holding company level combined – after the merger?**

133 A. The total of holding company debt outstanding as of December 31, 2015 for both holding
134 companies is projected to be 31.3% of the consolidated debt outstanding within the WEC
135 Energy Group holding company system.

136 **Q. Do the Joint Applicants propose any “ring-fencing” provisions in order to insulate**
137 **Peoples Gas and North Shore from Wisconsin Energy corporate debt and non-**
138 **utility operations? If so, please describe what those proposals are.**

139 A. The Joint Applicants are not proposing any new provisions of this nature. The
140 Transaction will reduce such exposure because WEC Energy Group’s holding company
141 debt and non-utility operations will be proportionally less than they currently are within
142 the Integrys holding company system.

143 **IV. CREDIT FACILITIES AND ACCESS TO CAPITAL MARKETS**

144 **Q. Will Peoples Gas and North Shore maintain their own credit facilities after the**
145 **Reorganization closes?**

146 A. Yes. Wisconsin Energy is not proposing to make any changes to the Gas Companies'
147 existing credit facilities after the merger closes. Peoples Gas has and will maintain its
148 own independent credit facilities. North Shore does not presently have its own
149 independent credit facilities and there is no plan to change this after the merger. Peoples
150 Gas and North Shore will remain able to borrow funds from each other pursuant to the
151 Uncommitted Revolving Credit Facility, Master Non-Negotiable Promissory Note
152 approved by the Commission in ICC Docket No. 04-0602, as well as from Integrys
153 Energy Group, Inc. pursuant to the Uncommitted Revolving Credit Facility, Master Non-
154 Negotiable Promissory Note approved by the Commission in ICC Docket No. 04-0603,
155 as amended in ICC Docket Nos. 10-0588 and 12-0284.

156 **Q. Will Peoples Gas and North Shore propose to join a WEC Energy Group “money**
157 **pool”?**

158 A. No, there is no present intention for the Gas Companies to enter into a “money pool
159 agreement,” as that term is defined in 83 Ill. Admin. Code § 340.20, with WEC Energy
160 Group or any other company after the closing of the Reorganization.

V. **CAPITAL STRUCTURE AND COSTS OF CAPITAL**

Q. What are the post-merger capital structures targeted for WEC Energy Group, Peoples Gas, and North Shore?

A. The post-merger capital structures targeted for Peoples Gas and North Shore are the same as those presented in the context of their currently-pending rate cases in ICC Docket Nos. 14-0224/14-0225 (cons.):

	North Shore	Peoples Gas
Long-Term Debt	38.94%	46.51%
Short-Term Debt	10.58%	3.16%
Common Equity	50.48%	50.33%

For WEC Energy Group, the projected post-merger capital structure is a debt-to-capital ratio of approximately 56%.

Q. What are the post-merger credit ratings targeted for WEC Energy Group, Peoples Gas, and North Shore?

A. The credit reporting agencies Standard & Poor's Ratings Services ("Standard & Poor's"), Moody's Investor Service ("Moody's") and Fitch Ratings ("Fitch") each issued updated reports after the merger was announced. Copies of these reports are attached to my testimony as Joint Applicants Exhibits 5.1 (Standard & Poor's June 23, 2014 Research Update), 5.2 (Moody's June 23, 2014 Rating Action), and 5.3 (Fitch June 24, 2014 Report).

The post-merger announcement reports of Standard & Poor's and Moody's affirmed the current ratings of Wisconsin Energy but changed their outlook for the

company to “negative,” and Fitch placed Wisconsin Energy on rating watch negative because the agencies opined that the debt to be incurred as part of the transaction left little room for underperformance in the company’s financial measures relative to forecasts. (See Joint Applicants Ex. 5.1 at 3-4; Joint Applicants Ex. 5.2 at 1; Joint Applicants Ex. 5.3 at 2) Based on these reports, the Joint Applicants believe the credit ratings for WEC Energy Group will remain at Wisconsin Energy’s current levels as shown in Joint Applicants Exs. 5.1 through 5.3 after the merger:

	Standard & Poor’s	Moody’s	Fitch
Long-term Debt/ Issuer Rating	A-	A2	A-
Senior Unsecured Debt	BBB+	A2	A-
Commercial Paper	A-2	P1	F2

Peoples Gas and North Shore are rated by Standard & Poor’s and Moody’s, but not by Fitch. Both Standard & Poor’s and Moody’s affirmed the Gas Companies’ credit ratings after the announcement of the merger. While Standard & Poor’s revised their outlook for the Gas Companies to negative, because their independent credit ratings are aligned with that of the parent company under Standard & Poor’s standards, Moody’s maintained their outlook as stable. Based on this information from these two credit reporting agencies, the Joint Applicants believe the credit ratings for the Gas Companies will remain at their current levels as shown in Joint Applicants Exs. 5.1 and 5.2 after the merger:

196

Peoples Gas

	Standard & Poor's	Moody's
Issuer Rating	A-	A2
Senior Secured/ First Mortgage Bonds		Aa3
Senior Secured MTN		(P)Aa3
Commercial Paper	A-2	P-1

197

198

North Shore

	Standard & Poor's	Moody's
Issuer Rating	A-	A2
Senior Secured MTN		(P)Aa3

199

200 **Q. Will the greater size and access to capital markets for the post-merger WEC Energy**
 201 **Group have an impact on Peoples Gas' and North Shore's costs of capital?**

202 A. As indicated in the Joint Applicant's Application (*see* page 9), it is anticipated that over
 203 the long-term WEC Energy Group will have enhanced access to capital, which may allow
 204 the Gas Companies to obtain debt at reduced cost in the future. There is no expectation
 205 that this will occur immediately. Peoples Gas and North Shore will continue to fund their
 206 operations and raise capital as they currently do, on an independent basis. As reflected in
 207 the expected post-merger credit ratings discussed above, the Joint Applicants do not
 208 expect any change to the Gas Companies' costs of capital as a result of the
 209 Reorganization either upon closing or soon thereafter. It is also important to note that the

financial markets are fluid and that a company's cost of capital is driven by a variety of factors including company-specific, competition for capital, and macro-economic conditions so while future benefits are expected they are not guaranteed and they would be relative to what might have occurred absent the Reorganization.

Q. How will any merger-related impact on Peoples Gas' and North Shore's cost of capital be reflected in its requested rates of return?

A. While I am not an attorney, it is my understanding that under Illinois law a utility's cost of capital is determined by the Commission treating an investor-owned utility on a stand-alone basis, comparing it with a proxy group of similarly-situated utilities to determine its return on equity. Any future reductions in the Gas Companies' cost of capital as a result of the greater size and access to capital markets of WEC Energy Group will be recognized and flowed through to customers in the rates set for the Gas Companies in the ordinary course when they file rate cases pursuant Illinois law.

Q. Are there any other assurances that any merger-related impact on the Gas Companies' cost of capital will be reflected in customers' rates?

A. Yes. It is my understanding that Illinois law prohibits a utility's cost of capital from being negatively impacted by the financial condition of its parent company pursuant to Section 9-230 of the Illinois Public Utilities Act (the "Act"). Further, in addition to the Commission having opportunities to review and approve the Gas Companies' costs of capital in Peoples Gas' and North Shore's future rate cases, it is my understanding that the Commission also has the authority under the Act to enter an order for interim rate relief if it ever finds that the Gas Companies are over-earning in-between their filing of rate cases.

233 **VI. FORECASTS**

234 **Q. As required by Section 7-204A(a)(7) of the Act, the Joint Applicants provided with**
235 **their Application, as Joint Applicants Exhibit 4.1, a forecast showing the capital**
236 **requirements of Peoples Gas and North Shore for the five years 2015 through 2019.**
237 **If the Reorganization does occur, what, if any, changes do the Joint Applicants**
238 **expect in this forecast.**

239 A. The Joint Applicants do not expect any changes to the forecasts of capital requirements
240 for Peoples Gas and North Shore presented in Joint Applicants Exhibit 4.1 in the event
241 that the Reorganization does occur. The Gas Companies have not finalized any updates
242 to their long-term financial plan forecasts since the filing of the Application in this
243 proceeding, and as I stated in my Revised Direct testimony (JA Ex. 2.0 REV, at 10:215-
244 217), Wisconsin Energy does not anticipate any changes to the capital requirements of
245 the Gas Companies shown in Joint Applicants Exhibit 4.1 as a result of the
246 Reorganization.

247 **Q. Please provide five-year forecasts of the Moody's and S&P financial benchmark**
248 **ratios for both Peoples Gas and North Shore assuming that the Reorganization did**
249 **not occur.**

250 A. Provided with my testimony as Joint Applicants Ex. 5.4 (CONFIDENTIAL and
251 PUBLIC) are the five-year forecasts of the Moody's and S&P financial benchmark ratios
252 for Peoples Gas and North Shore.

253 **Q. Do the five-year forecasts of the Moody's and S&P financial benchmark ratios for**
254 **both Peoples Gas and North Shore change if you assume that the Reorganization**
255 **does occur?**

256 A. No. The Joint Applicants do not anticipate any change in the five-year forecasts of the
257 Moody's and S&P financial benchmark ratios for Peoples Gas and North Shore if the
258 Reorganization does occur. The forecasted benchmark ratios for Peoples Gas and North
259 Shore provided in Joint Applicants Ex. 5.4 contain the best information the Joint
260 Applicants have at the present time.

261 **VII. CONCLUSION**

262 **Q. Does this conclude your supplemental direct testimony?**

263 A. Yes, it does.